

USAID/Bulgaria

Annual Report

FY 2005

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Bulgaria

Performance:

Background: During the past several years, Bulgaria has evolved as a leader in Southeast Europe rapidly moving ahead with its foreign policy priorities and making considerable progress in establishing a viable market-based democracy. With NATO membership already a reality, the country is focusing on EU accession in 2007. Despite these impressive developments and the irreversibility of the transition, reforms are far from complete. The majority of the population has not yet felt the change for the better, and Bulgaria remains a lower middle income country.

Regardless of a steady decline in public confidence and fierce attacks against the Prime Minister, particularly during the past two years, it appears that this will be the second government since the changes in 1989 to complete its full term. The right-wing political parties continued their fragmentation, and the government lost its Parliamentary majority; however, the likelihood for early elections is minimal. The left-wing opposition BSP continues to lead in the election preference polls, but the chances of right- and center-right parties to win majority through a post-election coalition in the next Parliament are increasing significantly. The change in the political balance comes from the recent hike in the popularity of the senior ruling partner NMS-II that places the party as an undisputable leader in the right-wing political spectrum. Still, it is premature to make projections on the outcome of upcoming Parliamentary elections in the spring of 2005 given the dynamic nature of Bulgarian politics.

The 2004 Regular Report of the European Commission on Bulgaria recognized that the country further consolidated and stabilized its institutions guaranteeing democracy, the rule of law, human rights, and respect for the rights of minorities. However, many reforms are incomplete. Implementation of legislative and administrative improvements in the judicial branch is lagging behind. Fiscal decentralization and the strengthening of local governance require removal of constitutional barriers to the financial autonomy of municipalities. Regional and local governments lack the capacity to effectively manage EU structural funds. The 2004 Corruption Perception Index of Transparency International showed a slight improvement from 2003, ranking the country before Latvia, Slovakia, Poland and Romania. This is a positive sign, but corruption, particularly at high political levels, and organized crime continue to be major problems. Notwithstanding the favorable legal environment and increased number of active NGOs, the sustainability of the civil society sector remains fragile, with more than 80% of its funding still coming from foreign sources. Media, while generally free, face pressure from the government and special interest groups. People from ethnic and cultural minorities, notably the Roma, continue to be marginalized.

Strong support by all political parties for the country's EU accession drove macroeconomic policies and structural reforms, resulting in sustained economic growth, low inflation, progress in privatization, and credit expansion in the past couple of years. Real GDP growth exceeded 4% a year since 1998, and according to preliminary estimates the economy grew by 5.6% in the first half of 2004 compared with 4.3% in 2003 as a whole. The 2004 EBRD Transition Report points to Bulgaria as a leader in Southeast Europe in implementing market oriented reforms, achieving big progress in improving the overall investment climate and competitiveness indicators. Bulgaria leapfrogged Poland to take 59th place in The Global Competitiveness Report 2004-2005, recently released by the World Economic Forum. The inflow of Foreign Direct Investments grew and is expected to reach a record high of \$3.1 billion by the end of 2004. Central Bank data shows that foreign capital deployed in Bulgaria in the first half of 2004 topped last year's \$1.6 billion mark. Despite the good macroeconomic performance record significant challenges remain ahead. The EU recognizes Bulgaria as a functioning market economy but warns that reforms must continue for it to cope with EU competitive pressures and market forces in the near term. Bulgaria's further economic progress is hindered by an inefficient judicial system, corruption and organized crime, persisting administrative barriers for businesses and foreign investors, and a high trade deficit.

Despite the impressive reforms undertaken over the last six years, Bulgaria remains among the poorest EU applicants. After 15 years of democratic government, the average Bulgarian has not seen tangible economic benefits. Per capita income is still about 30% of the EU average with unemployment and low living standards persisting. Although the government is pursuing an active employment-creation policy, which resulted in a decline in unemployment to a record low of 11.7% at the end of the third quarter of 2004, unemployment levels are double the EU average and remain among the highest in the region. With a monthly minimum wage of \$76, an average salary of \$190, and average pension of \$80, Bulgaria maintains the lowest compensation levels in the region. Structural weaknesses of the labor market are long-term unemployment, high youth unemployment among those with lower education and skill levels, and wide regional variations. Health care reform continues at an uneven pace and often is cited as a reason for public discontent. The educational system is also failing to meet the needs of the country's job market. The population's health status is well below the EU average. Although HIV/AIDS infection rates remained low, a World Bank report warns about the possibility of a pandemic increase in the region.

In the spring of 2005, Bulgarians will vote for a Parliament that will appoint a new government with a primary mission of bringing Bulgaria into the EU. Given the lack of a strong leader on the political scene, there are serious concerns about the stability of the next cabinet. Without strong political support, reform is threatened by setbacks.

U.S. Interests and Goals: The USG priority interests in Bulgaria remain its regional stability and continuing support for the Global War on Terrorism. Situated in a highly volatile region, Bulgaria managed to assert itself as a stable political and economic anchor in Southeast Europe, contributing to the stabilization of the Balkan region and acting as a reliable partner of the U.S. over the past several years. In this context, the USG overall goal is to ensure that Bulgaria continues to play a responsible and proactive role on the international arena while remaining a factor of stability in the region. In order to achieve that, the overall U.S. strategy in Bulgaria includes five top priority strategic goals: counter-terrorism, regional stability, enhanced rule of law, economic development and job creation, and strong democratic institutions and human rights. USAID contributes to all five strategic goals of the Mission's Performance Plan and directly focuses on three of them.

Rule of Law (ROL) is the centerpiece of USG assistance program given that improvements in this area may determine the country's long-term stability as an ally and will be a major factor for its EU accession. To assist in the process of institutionalizing the rule of law, USAID devotes resources to modernize the court administration, increase the capacity of legal professionals to apply the law equitably and swiftly, and combat corruption and trafficking in persons. In the area of local governance, USAID assistance focuses on fiscal decentralization, building the capacity of municipalities to cope with increased responsibilities and supporting NGOs that advocate on behalf of local governments. This effort is complemented by community level activities, which provide increased opportunities for ethnic minorities and encourage greater ethnic tolerance. Building stronger civil society organizations, strengthening parliamentary practices, and improving the advocacy of the independent media further support Bulgaria's transition to a strong democratic society. On the economic front, USAID fosters the development of a competitive and thriving market economy as an approach to spread the benefits of increased prosperity for the majority of Bulgarians. USAID programs support the reform efforts of the Bulgarian government in creating a business-friendly environment that attracts investments and encourages the growth of SMEs. Direct technical assistance to individual firms and competitive industry sectors promotes trade and investment. In addition, USAID programs provide additional opportunities for access to financial resources, thus boosting the growth of the private sector and job creation. The Mission continues to support the reform of the labor market, targeting its efficiency as a prerequisite for economic growth.

USAID activities are integrated into the overall USG assistance program and are complemented by the efforts of the Department of State (media, civil society, educational exchange), the Department of Agriculture (economic development), the Department of Justice (law enforcement and organized crime), the U.S. Treasury (tax policy and law enforcement), and the Peace Corps (community development).

Donor Relations: Recognizing the modest interest of the Government of Bulgaria (GOB) in taking the lead

of the effort, donors tried new approaches to improve their collaboration. A one-day retreat for all key donors occurred twice in 2004. The retreats were organized by donors on a rotational basis. GOB representatives also participated. Topical discussions on one or two priority issues proved extremely useful. The retreats complemented the regular brief meetings of key multilaterals and USAID, primarily for the purpose of information sharing. Several donors are reducing their assistance programs in view of the EU accession, with DFID closing out in March 2005.

The EU is the largest donor allocating approximately \$350 million per year with the primary objective to prepare the country for EU accession. USG assistance programs are in general consistent with the requirements which the country must meet for EU accession. The EU has the greatest potential for assistance in the judicial reform and public administration area. In the judicial area, USAID efforts for providing court automation equipment for model courts and developing the case management system software laid the foundation for a nation-wide EU court automation project. USAID successfully coordinates its anti-corruption program with the EU, particularly in the decentralization of Bulgaria's internal audit. Working together on commercial law issues, the EU takes the lead in the area on bankruptcy, while USAID focuses on company registration, collateral issues, alternative dispute resolution on commercial matters and overall enforcement of commercial judgments. Although no other donor is comprehensively addressing local government reform, the Swiss Government, the British Government, and the World Bank complement USAID activities with demonstration projects on a limited geographic basis. Major donors coordinating efforts with USAID in the business environment are: the EU (strengthening associations and business consulting companies), GTZ (export promotion and association strengthening), UNDP (development of business support centers), the World Bank and DFID (regulatory framework improvement). The World Bank and USAID are the only donors supporting the healthcare reform in Bulgaria. While the Bank provides equipment and assists in the overall sector restructuring, USAID complements its efforts with key technical assistance. The EU and UNDP focus on job creation and poverty alleviation by working with governmental institutions, while USAID approaches the issues by working at community level.

Challenges: Bulgaria completed its EU accession negotiations and will sign its accession treaty in 2005. The big challenge for the GOB is to make sure that all negotiated reforms and changes are implemented and produce the expected results. This means that reform efforts must continue at a faster pace. ROL deficiencies still represent Bulgaria's most outstanding issue, further exacerbated by corruption and organized crime. The deficiencies include: a lack of transparency and accountability, serious delays in the judicial system; legal professionals with inadequate legal expertise and experience; the politicization of the judiciary; human trafficking; and an inadequate capacity to limit governmental waste, fraud and abuse. These issues feed general distrust in the public institutions, hamper business investment, and prevent Bulgaria from meeting the international and EU rule of law standards.

On the economic front, Bulgaria continues on the right track by maintaining economic growth and financial stability. The development of a robust private sector as the engine for growth, job creation and economic prosperity is on-going. At the same time though, there are many Bulgarians who have not felt the change for the better. Living standards have not improved for all Bulgarians. Ethnic minorities, the long-term unemployed, and people with low education continue to face poverty. One of the key challenges therefore is to ensure that growth generates prosperity for all groups in society. To realize Bulgaria's potential and meet the aspirations of all, the country must stay on course in tackling the remaining challenges in its transition agenda such as: the creation of an efficient and competitive business environment; finalizing second generation economic reforms; putting in place better and transparent government systems, and improving the quality and access of social services for all citizens.

The outcomes of the upcoming Parliamentary elections pose a major challenge to the pace of reform in Bulgaria. The lack of strong support for any of the political parties will impose the need for establishing coalitions. This raises concerns about the political stability of any new government and its ability to drive the reforms. These issues might be exacerbated by the lack of appropriate administrative capacity to absorb the upcoming EU structural funds, particularly at local and regional levels.

Key Achievements: FY 2004 was devoted to program implementation with an eye on the graduation from

USG assistance after 2007. USAID declared victory in the areas of nature conservation, banker training, chitalishte development, and local community planning leaving tangible results. Another set of programs such as the firm level assistance and the bank supervision activities were completed successfully, followed by the launch of new mechanisms that will continue to address priority issues in the respective sectors. Last year, the Mission refined the final phase of its assistance programs supporting the judicial reform, enhancing local governance, and promoting the growth of the private sector. The conditioned approach to providing assistance to the government has been successful. The GOB has been a good partner and has made possible the achievements of USAID assistance in the policy and legislative reform. Overall, FY 2004 saw good progress of USAID program in Bulgaria. The three SOs achieved their targets and Mission's graduation is on track.

Rule of Law: This SO supports judicial reform and strengthening GOB's institutional capacity to prevent corruption and enhance transparency especially in the area of public procurement. The beneficiaries are all Bulgarians and a good number of foreign investors who suffer from the inefficiency of the judicial system and corrupt practices. The mastery of the legal intricacies and new processes is crucial to the successful implementation of Bulgaria's reforms. That's why a landmark of USAID judicial program is the National Institute of Justice (NIJ). The NIJ will train judges and court staff in substantive law, skills training and court administration. This institution is one of our most significant legacies and is one of the most sophisticated training centers in Eastern Europe. In addition, the past year marked the adoption of a series of important legislative acts and amendments. USAID assistance boosted judicial reform with the enactment of amendments to the Judicial System act that defined clear rules for the appointment and promotion of magistrates and the establishment of the court administrator position. After several years of USAID assistance, the Attorneys Act was passed by the Parliament and enacted in June 2004. The new law mandates a rigorous professional qualification exam, a modern Code of ethics and continuing legal education.

A significant part of USAID support focuses on fighting corruption and building on the demonstrated commitment of key GOB institutions to reform. The most significant achievements of USAID assistance were in the area of public procurement. A new Public Procurement Law was passed, implementing regulations were developed, and a Public Procurement Agency was established. This completes the legislative and institutional infrastructure to regulate effectively Bulgaria's public procurement process. Parliament passed sweeping changes to the Law on Political Parties banning anonymous donations, regulating the use of non-financial donations and stipulating a stronger role for the National Audit Office to audit political parties' finances.

Economic Growth and Increased Prosperity: Through this SO, the Mission seeks to foster the development of a competitive, transparent, and business-friendly environment that is conducive to job creation, private sector growth, and long-term prosperity. A major success of USAID economic portfolio in FY 2004 is its contribution to increased investments in Bulgaria. The Mission supported the GOB with the development of a National Investment Strategy and Invest Bulgaria 2004 guidebook, which is now broadly used to promote the country's potential for investment and economic development. USAID advisors assisted with the development of the new Law on Promotion of Investments and a new Energy Law. The introduction of a transparent legal energy framework, predictable tariff mechanisms and uniform accounting systems created regulatory stability and predictability. That was critical to increasing investors' confidence. These efforts were essential for the successful privatization of the seven electricity distribution companies in the country. USAID assistance is instrumental in the sale of concession rights for the two Black Sea airports, Varna and Burgas. The transaction will result in foreign direct investments, estimated at \$160 million over 10 years.

USAID was active with the development of a business friendly environment that leads to private sector growth and improved competitiveness. Mission's persistent efforts to reform the antiquated system of business registration, which takes up valuable court resources and imposes undue barriers to market entry, resulted in a major breakthrough - a political decision for a radical reform of business registration, which will remove it from the court system. USG fostered the development of the National Council for Economic Growth (CEG) at the Ministry of Economy, already the leading GOB body for public-private dialogue and policy formulation. With the CEG's support the GOB endorsed the cluster based economic

development strategy and competitiveness approach, which became the overarching theme for all economic policies in the country. USAID provided technical assistance in support of the Act on Small and Medium Enterprises (SMEs) which was passed by Parliament.

The USAID micro-lending program continues to be the leading one in the country. The two micro-finance institutions sustained their lending operations throughout the entire country and there are now more than 20 branch offices. By September 2004, the number of active clients exceeded 7,000 borrowers. The active outstanding portfolio increased to \$5.6 million as compared to the \$4.5 million a year earlier. USAID/Bulgaria micro-credit portfolio helped to create 7,675 new jobs and sustain close to 16,000 in the country. The two micro-lending institutions are self-sustainable. These programs maintained their commitment to provide equal access to financial services to the smallest and most disadvantaged micro-entrepreneurs and over 60% are female customers.

In the Labor Market area, USAID assisted the GOB to increase the effectiveness of country's labor markets as a major prerequisite for economic growth. As part of that effort, significant work was done in the IT area to enable prompt and efficient registration (including on-line registration) of more than 200,000 new labor contracts. 9,800 cases of fraud were detected by cross-matching data from the labor contracts register and the unemployment compensation database. By tracking rapidly the compliance of employers with minimum social insurance thresholds, the administrative costs of compliance and verification of collections was reduced by \$330 million. USAID technical assistance helped the newly emerging pension industry to improve its transparency, increase its compliance with pension laws, and boost public trust and participation in mandatory and voluntary pension funds. The number of participants in mandatory and voluntary funds grew by 50 and 11 percent respectively during the last four years.

Local Governance: This SO focuses on implementing fiscal decentralization, enhancing the capacity of municipalities to function in a decentralized environment, and on increasing the ability to address community building issues through increased local participation and building public private partnerships. One of the biggest achievements of the Mission during the past year was its contribution to the smooth transition after the local elections, attributable to the extensive training provided to the municipal governments. Within the first quarter of 2004, the orientation program for the newly elected mayors and municipal officials reached all municipalities - over 700 elected and administrative officials. USAID made progress towards the decentralization of authorities in the country. Amendments to the Municipal Property Act increased the municipal authority in property management and created greater transparency in dealing with municipal properties. As a result, the municipal share in total municipal revenues increased from 32% in FY 2003 to 33.8% in FY 2004. The total municipal revenues per capita marked an 8% increase during the past year.

With the completion of the PLEDGE and Chitalishte programs in FY 2004, USAID left two nation-wide models of community participation in Bulgaria. The PLEDGE project pioneered community development in Bulgaria by involving thousands of citizens in local economic renewal. The program created a network of trained volunteers in 54 communities who became facilitators, organizing a broad base of community partners into a strategic planning team. The outcomes of the program include: 4,909 new jobs; 739 retained jobs; 158 business starts; 504 businesses assisted; and 998 inter-industry partnerships. The Chitalishte project, jointly funded by USAID, UNDP, and the Government of the Netherlands, made tangible impact in 92 Bulgarian communities. Sixty-seven Chitalishte implemented pilot projects that built on the traditional strengths of Chitalishte as guardians of Bulgarian culture and demonstrated how they can continue to serve as a modern and vital community organization in the 21st century.

USAID programs fostered public-private alliances by engaging the private sector, local government, and average citizens in resolving community issues. Ten concept projects in six municipalities were approved and \$177,873 were raised locally and matched with USG funds. Ethnic integration efforts created models for addressing social, economic, and educational problems in towns having large Roma and/ or Turkish populations. Over seventy projects were funded to improve the educational, economic and social opportunities for Roma and Turks. A successful alliance with an indigenous entity was established in 2004 to further replicate the integration model in Muslim communities. USAID developed a governmental social program for ethnic integration at the request of the Ministry of Social and Labor Policy.

Crosscutting Initiatives: After 12 years of involvement, USAID successfully completed support to nature conservation and sustainable development in Bulgaria with the establishment of the Protected Areas Fund (PAF) - the first conservation trust fund in Eastern Europe. The PAF is envisioned to become a sustainable mechanism for financing protected areas activities.

Results Framework

183-0130 Economic Growth and Increased Prosperity

SO Level Indicator(s):

- GDP per capita as percent of EU average
- 1.3.1. Improved Business Climate
 - 1.3.1.1. Improved and Transparent Legal and Regulatory Environment (in cooperation with US Treasury and USDA)
 - 1.3.1.2. Improved Social Sector Performance to Promote Business Opportunities
 - 1.3.1.3. Effective Legal Policies and Practices to Promote Transparency (in cooperation with ROL team)
- 1.3.2. Jobs Created through Strengthened Private Sector
 - 1.3.2.1. Sustained SME Growth
 - 1.3.2.2. Trade Capacity Built and Promoted
 - 1.3.2.3. More Efficient Labor Markets
- 1.3.3. Improved Access to Financial Resources
 - 1.3.3.1. Reduced Barriers to Credit
 - 1.3.3.2. Increased Investment in the Economy
 - 1.3.3.3. Sustainable Micro-lending Mechanisms Developed
- 1.3.4. A More Competitive Agricultural Sector, USDA

183-0140 A More Competitive and Market Responsive Private Financial Sector

183-0210 Increased, Better-Informed Citizens' Participation in Public Policy Decision-Making

183-0220 Enhanced Rule of Law

SO Level Indicator(s):

- Freedom House Nations in Transit ROL Score
- 2.2.1. A Strengthened Judicial System
 - 2.2.1.1. Improved Court Administration
 - 2.2.1.2. Improved Capacity of Legal Professionals
 - 2.2.1.3. Key Laws and Regulations Support Effective ROL
- 2.2.2. Reduced Corruption through Enhanced Transparency & Accountability
 - 2.2.2.1. Procurement Policies and Procedures Enacted and Implemented to Increase Integrity
 - 2.2.2.2. Strengthened External and Internal Audit Mechanisms
 - 2.2.2.3. Increased Capacity of CSOs and Media to Demand Greater Transparency and Accountability of Public Institutions
- 2.2.3. Improved Law Enforcement Mechanisms (US Treasury, DOJ)
 - 2.2.3.1. Regional Criminal Justice against organized crime
 - 2.2.3.2. Prosecutorial Strengthening
 - 2.2.3.3. Frauds and Financial Crimes Task Force

183-0230 Local Governance More Effective and Accountable

SO Level Indicator(s):

- Index of Local government Effectiveness and Accountability
- 2.3.1. Authority, Responsibility & Resources Decentralized to Local Government
 - 2.3.1.1. Key Laws to Support Decentralization in Place
 - 2.3.1.2. Increased Fiscal and Administrative, Decision-making and Service Delivery Capacity of Local Government
- 2.3.2. Increased Ability to Address Community Building Issues
 - 2.3.2.1. Increased Citizen Participation, Especially by Vulnerable Groups, in Policy Decisions
 - 2.3.2.2. Increased Community Generated Resources to Address Local Problems

183-0410 Special Initiatives

183-0420 Program Support Objective